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C O N F I D E N T I A L SECTION 01 OF 02 BAKU 000370

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DEPARTMENT FOR EUR/CARC AND EB/ESC
DEPT OF ENERGY FOR FE - SWIFT AND OS - WILLIAMSON

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SUBJECT: BARM EK'S TROUBLES PAINT GRIM PICTURE FOR POWER
SECTOR REFORM IN AZERBAIJAN

Classified By: DCM Jason Hyland, reasons 1.5 (b), (d) and (e).

11. (C) SUMMARY: The truce between Azerbaijan state electricity company AzerEnergy and Turkish power company Barmek, which buys electricity from AzerEnergy for distribution to consumers, has broken down. President Aliyev lent support to AzerEnergy chief Pirverdiyev's public attack on the company and the International Bank of Azerbaijan has cut off its line of credit. Barmek has also been hit with criminal charges alleging corruption, embezzlement, misuse of state property, and links to deposed former Economic Development Minister Farhad Aliyev. There is open speculation that Barmek will pull out of Azerbaijan. Although Barmek may well have engaged in corrupt activities, the friction with AzerEnergy stems also from Barmek's deduction of the cost of unpaid GOAJ bills from its payments to AzerEnergy, which it is apparently entitled to do under its contract. This, coupled with AzerEnergy's rejection of an EBRD loan (which would have required certain reforms) and the GOAJ's decision not to establish an independent energy regulator all indicate a bleak outlook for power sector reform in Azerbaijan. END SUMMARY.

12. (SBU) Barmek is the Turkish power-distribution company operating in Baku. It buys electricity from AzerEnergy, the state power company, and distributes this electricity to consumers. Barmek was brought into Azerbaijan by the late President Heydar Aliyev, who envisioned a large-scale restructuring of the power sector along market principles. Following his death, this process slowed. Currently, many of Barmek's customers, especially large government entities, are not paying their bills. About two years ago, Barmek began deducting the cost of these unpaid bills from the amount it pays to AzerEnergy, which it is allowed to do under its contract.

13. (C) The GOAJ, led by AzerEnergy and supported by the Tax and Finance Ministries, began a serious assault on Barmek over this issue in the summer and fall of 2005, including harassment and public criticism. The GOAJ backed off for a while, apparently due to the intervention of President Aliyev and perhaps due to a request from high levels in the Turkish Government. On February 27, however, AzerEnergy President Etibar Pirverdiyev had a public audience with President Aliyev which observers have characterized as a staged performance. Pirverdiyev attacked Barmek as responsible for recent power outages in the country and accused Barmek of not paying its bills to AzerEnergy. President Aliyev, in an angry response, instructed AzerEnergy and the Cabinet of Ministers to take the situation "seriously" and to take "drastic measures" to deal with Barmek's alleged failures.

¶4. (C) USAID contractors working on power sector issues (PA Consulting) interpreted the public audience as the beginning of a new GOAJ campaign against Barmek. Indeed, on February 28, Barmek chief Huseyn Atabul encountered some harassment at the airport at the start of a planned journey to Ankara. That same day, the International Bank of Azerbaijan (IBA) rescinded Barmek's line of credit, which the company uses to make its payments to AzerEnergy. Thus, Barmek was unable to make its January payments and therefore is technically in breach of contract.

¶5. (C) On March 6, the Prosecutor General brought criminal charges against Barmek for corruption, misuse of state property and embezzlement. The Prosecutor General also alleged a connection between Atabul and former Minister of Economic Development Farhad Aliyev, who was detained in October 2005 on charges of plotting a coup. Specifically, Barmek is accused of transferring large sums of money to a British company linked to Farhad Aliyev for "unfulfilled services." Atabul's plans are unknown, but many consider it likely that Barmek will pull out of Azerbaijan. Earlier, Barmek survived only because of President Aliyev's intervention. Now, as a Turkish Embassy official put it, "President Aliyev is clearly in AzerEnergy's camp."

¶6. (C) At the same time that he denounced Barmek, Pirverdiyev announced that AzerEnergy was no longer in negotiations with the EBRD for a loan to rehabilitate some of its facilities. A feasibility study was done by PA Consulting but AzerEnergy was uncomfortable with the conditionalities EBRD wanted to impose on the loan (NOTE: This is not the first time a state-owned company has refused lending from an IFI at the last moment. In most cases, the lending conditions prove too stringent or the conditions of the financing do not meet the

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government's satisfaction). They may deal with a Russian company instead. RAO UES is rumored to be interested in Azerbaijan's market, and RAO UES executive Anatoly Chubais visited Azerbaijan to explore such opportunities last year.

¶7. (C) COMMENT: Some in the international energy community in Baku are unsympathetic to Barmek's plight. These observers believe that Barmek secured its original entry into the market back in 2000 via a corrupt deal with Farhad Aliyev and others. How else, they ask rhetorically, would an obscure Turkish company manage to beat out international giant Siemens for the tender, and to secure operating conditions far more generous than the German company had been promised? But regardless of how Barmek got into Azerbaijan and where it goes from here, its experience, coupled with AzerEnergy's rejecting the EBRD's loan and with the GOAJ's decision not to go ahead with the creation of an independent energy regulatory agency, paints a grim picture for the future of power sector reform in Azerbaijan. In addition, the government's harassment of Barmek and its possible departure send the wrong signal to international investors looking to do business in Azerbaijan. END COMMENT
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